



**Investment Office**

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March 17, 2008

**AGENDA ITEM 9c**

**TO: MEMBERS OF THE INVESTMENT COMMITTEE**

- I. SUBJECT:** Corporate Board Diversity
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

**Executive Summary**

In response to a letter submitted by California State Controller John Chiang, the Chair of the CalPERS Investment Committee directed staff to prepare this agenda item. This agenda item includes an update on current activities on this issue as well as key findings from five organizations that have collected diversity statistics for US Corporate Boards of Directors. Observations from a special report written by the Wall Street Journal are also included in this agenda item.

**Background**

**Letter from the California State Controller**

By letter dated February 6, 2008 (Attachment 1), California State Controller John Chiang "urged CalPERS to consider a new initiative that would proactively address the issue of diversity on the boards of corporations in which CalPERS invests." State Controller Chiang's letter also requested staff to prepare a report containing survey data on corporate board diversity for the March meeting of the Investment Committee. In addition, the letter states that the Investment Committee might also consider specific actions such as:

1. Amend the current Policy on Corporate Governance Director Nominations to specifically address the issue of diversity in situations where CalPERS is nominating directors.
2. Sponsor the development of an issue paper that sets forth best practices for corporations to follow in seeking diversity on their boards.
3. Actively engage companies on this issue in the Focus List process as well as in other engagements and, where appropriate, file or co-file shareowner proposals on board diversity.

Finally, State Controller Chiang's letter specifies that: "Diversity in the boardroom ensures a wider range of talents, ideas and viewpoints. This inherently leads to greater creativity, more vigorous deliberation and debate, and more integrity of processes, all of which are desirable traits for a board and are consistent with principles of good corporate governance." This specific position statement is in accordance with the stance the CalPERS Core Principles of Accountable Corporate Governance takes on board processes and evaluation.

### **Current CalPERS Activity**

#### **Core Principles of Accountable Corporate Governance**

The CalPERS Core Principles of Accountable Corporate Governance (Principles) creates the framework by which CalPERS executes its proxy voting responsibilities. In addition, the Principles provide a foundation for supporting CalPERS' engagement activity tied to corporate governance initiatives. CalPERS' Principles state that as part of a board's director nomination process, "consideration is given to the mix of director characteristics, experiences, diverse perspectives and skills that are most appropriate for the company. The board should address historically under-represented groups on the board, including women and minorities."

#### **Portfolio Company Engagement**

Corporate Governance staff engages portfolio companies through the Focus List Program, the Corporate Governance Investment Program, the Environmental Strategic Plan and specific initiatives including but not limited to improving a portfolio company's executive compensation policies and practices and the adoption of a majority vote provision for director elections. In those cases where CalPERS staff believes it is in the best interest of shareowners to nominate directors to corporate boards, this activity is carried out in a manner consistent with the CalPERS Statement of Investment Policy for Corporate Governance

Director Nominations and supported by the CalPERS Principles of Accountable Corporate Governance.

### **Proxy Voting**

During the last proxy season a total of two shareowner proposals on Board Diversity were filed at portfolio companies. One proposal was filed at Lincare Holdings Inc. by Calvert Asset Management Company. The proponent requested that the board of directors:

- Take every reasonable step to nominate women and racial minority candidates to the board.
- Publicly commit itself to a policy of board inclusiveness by amending the nominating committee's charter to ensure that women and minority candidates are routinely sought as part of every board search, that the board strives to obtain diverse candidates by searching in traditional corporate environments as well as government, academia and non-profit organizations, and that board composition is reviewed periodically to ensure the board reflects the knowledge, experience, skills expertise and diversity required for the board to fulfill its duties.

The other proposal was filed at Activision by The Fetzer Institute. This shareowner proposal requests that the board of directors:

- Ensure that women and persons from minority racial groups are among candidates that it considers for nomination to the board.
- Publicly commit itself to a policy of board inclusiveness, including steps to be taken and a timeline for implementing that policy.
- Report to shareowners, at a reasonable expense and by a specific date, on its efforts to encourage diversified representation on the board and whether diversity is included in the nominating and corporate governance committee's procedures and a criterion in selecting the total membership of the board.

With regards to the Lincare Holdings Inc. proposal, both RiskMetrics (ISS) and Proxy Governance recommended a "For" vote while Glass Lewis recommended shareowners vote "Against". ISS, Glass Lewis and Proxy Governance recommended a vote "Against" the proposal filed at Activision. Neither proposal received sufficient support to be adopted. The percentage of votes cast "For" the proposals was 31.6 percent and 10.5 percent at Lincare Holdings Inc. and Activision, respectively.

### **CalPERS Director Nomination Policy**

At the May 2007 meeting of the Investment Committee, a Policy Subcommittee recommendation was accepted by the Committee to approve the revised Statement of Investment Policy that governs Corporate Governance Director Nominations. This policy states two criteria director candidates should meet, but is silent on the impact the candidate should have on corporate board diversity. The two criteria are:

- Competence: A director candidate should possess the requisite range of skills, knowledge and experience to enable them to discharge their duties and responsibilities.
- Independence: A director candidate should be able to exercise judgment in the best interests of the corporation free of any external influence that may attempt to be or may appear to be exerted upon them.

### **Survey Data**

Below are the key findings from five organizations that have collected diversity statistics for US Corporate Boards of Directors.

#### ***2007 Spencer Stuart Board Index***

- Among the boards at the largest 200 S&P 500 companies, minorities account for 14 percent of all directors in 2006, down slightly from 2005.
  1. 9 percent of directors are African American
  2. 4 percent of directors are Hispanic
  3. 1 percent of directors are Asian

#### ***2007 Corporate Board Report Card; Corporate Board Initiative of The Committee of 100, Inc.***

- Asian and Asian Pacific Americans hold 1.5 percent of corporate board seats among Fortune 500 companies in 2006 compared to 1.2 percent in 2005.
- Women held 22 percent of the 1.5 percent corporate board seats occupied by Asian and Asian Pacific Americans.

#### ***Women and Minorities on Fortune 100 Boards; The Alliance for Board Diversity***

- 14.9 percent of board seats at Fortune 100 companies are held by a minority individual.

- 16.7 percent of board seats in the Fortune 100 are held by women.
- 3 percent of board seats at Fortune 100 companies are held by minority women.
- Very few Fortune 100 boards have representation from all minority groups.

***HACR Corporate Index 2004; Hispanic Association on Corporate Responsibility***

- Hispanics hold 1.97 percent of all available board seats at the 1000 largest US companies.

***Report Card-Bush's Cabinet Diversity Should be the Model for the Banking Industry: Diversity at the Board of Directors of the Twenty Largest Banks; The Greenlining Institute***

- Overall minority representation on our nation's top 20 bank boards has barely grown over the last year; 38 of 295 in 2005 (12.9%) and 41 of 292 in 2006 (14.0%).
- As of December 2006, there were only two Asians among the 292 board directors of the twenty largest banks.
- As of December 2006, there were only 12 Latino board members among the 292 board directors at the twenty largest banks.
- With only five exceptions, the 20 largest banks have only one "token" African American board member.

The following observations were made about corporate board diversity in a special report by the Wall Street Journal titled "Some Things Don't Change: Sarbanes-Oxley was expected to increase the number of minority directors: What happened?" (January 16, 2008 by Phred Dvorak)

- Ethnic and racial minorities remain underrepresented on US corporate boards, comprising roughly a tenth of big company directorships, versus a third of the population. The percentage of board seats minorities hold has barely budged since 2000.
- The percentage of companies in the Standard & Poor's 500-stock index with no minority directors at all went up during the past several years to 41 percent in 2007 from 36 percent in 2000.
- Overall, Black, Hispanic and Asian directors hold only 11 percent of board seats at S&P 500 companies compared to 10 percent in 2000.
- Black, Hispanic and Asian women held 3 percent of the board seats of Fortune 500 companies in 2007, down from 3.7 percent in 2003.
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- Independence: A director candidate should be able to exercise judgment in the best interests of the corporation free of any external influence that may attempt to be or may appear to be exerted upon them.

### **Next Steps**

Staff seeks direction from the Investment Committee Chair regarding next steps. We are prepared to discuss the actions proposed by the Controller and if directed, staff can return to the Committee with a range of options for the proposed actions.

### **V. STRATEGIC PLAN:**

This agenda item is consistent with the Strategic Plan: Goal IX, achieve long-term, sustainable, risk adjusted returns.

### **VI. RESULTS/COSTS:**

Costs will be a function of the direction to staff provided by the Investment Committee Chair.

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